

Supreme Court, U. S.

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# Supreme Court of the United States.

OCTOBER TERM, 1977.

No. 77-334.

FIRST FEDERAL SAVINGS AND LOAN  
ASSOCIATION OF BOSTON, ET AL.,  
APPELLANTS,

v.

STATE TAX COMMISSION, ET AL.,  
APPELLEES.

ON APPEAL FROM THE SUPREME JUDICIAL COURT  
OF MASSACHUSETTS.

**Reply Brief for the Appellants.**

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**Reply Brief for the Appellants.**

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The Appellants reply as follows to the brief on the merits ("Brief") filed by the State Tax Commission ("Commission").

**A. Credit Unions.**

The Federal tax exemption of credit unions, heavily relied upon by the Commission, reflects at most a Federal judgment regarding a class consisting of the credit unions of all states, as well as Federal credit unions — and not a judgment regarding certain large Massachusetts credit unions. The Federal judgment was entered in 1951 —

twenty-seven years ago. In recent years, the Federal policy has been under review with changes recommended. Brief at 29, n.44.

The current Federal Executive judgment on the same issue is contained in President Carter's Tax Message as sent to Congress on January 21, 1978. The portions of the message applicable to credit unions are as follows:

Credit unions were exempted from taxation in the days when these institutions were small entities with close bonds among the members and few powers to provide extensive financial services. I am recommending changes that will recognize the contemporary practices of financial institutions and will bring the tax treatment of . . . savings and loan associations and credit unions more in line with the taxation of other businesses.

and:

(3) Credit Unions. Credit unions are tax-exempt. Yet, their powers and functions are defined so broadly that the term "credit union" can include financial institutions that are *functionally identical to a savings and loan association*. The tax exemption provides them with an unfair financial advantage over their competitors. I propose that the percentage of exempt income be phased out over a 4-year period, and that credit unions be taxed in the same manner as mutual savings banks and savings and loan associations after 1982.

(Emphasis supplied.)

Because of 12 U.S.C. §1464(h), Massachusetts was obligated to arrive at the same judgment in 1966, when it first imposed a tax on Federal savings and loan associations. By refraining from naming specific institutions, referring only to ones that were "similar," Congress utilized a phrase

capable of reaching new or changed institutions. By choosing to tax Federal savings and loan associations in 1966, Massachusetts was obligated to include all similar institutions within the scope of the tax enacted, including at least the largest credit unions.

### B. Guaranty Funds.

The Massachusetts statute allows a deduction from gross income for minimum required additions to a "guaranty fund or surplus." Mass. G.L. c. 63, §11. An understanding of the function of such reserves is critical to the issues presented.

The Commission persistently errs in its description of the character and purpose of a guaranty fund. In its brief in support of its Motion to Dismiss, the Commission states that a guaranty fund "is not available . . . for investment." Brief in Support of Motion to Dismiss at 16. In its brief on the merits, the Commission states that:

Each institution is disadvantaged in its profit-making activities to the degree that *it must take these funds out of circulation*.

(Emphasis supplied), Brief at 10-11, and:

It is the institutions with higher guaranty fund requirements which bear a comparative burden, *by having to take more money out of circulation*.

(Emphasis supplied), Brief at 21.

The implication that reserve additions reduce real income is erroneous. The implication that reserve additions reduce assets available for investment is simply wrong. The reverse is true. Additions to surplus add, rather than detract from, earning capacity. A guaranty fund is fully



available for investment and is in no way "out of circulation."

A guaranty fund may be best characterized as the equivalent of the capital stock investment shown on the books of a business corporation. It represents the minimum corporate capital required for sound operations and thus may not be distributed to members, just as distributions to stockholders may not impair the capital of a business corporation under general corporate law. Like the capital account of a business corporation, a guaranty fund is fully utilized in the business. Guaranty funds, or their equivalents, represent the minimum accumulated earnings and profits of the thrift industry. *See* S. Rep. 781, 82d Cong., 1st Sess., U.S. Code Cong. and Adm. Serv. 1997 (1951).

The statutory provisions related to guaranty funds and required reserves are attached for convenience as an appendix hereto.

For the foregoing reasons, the Appellants renew their request that Mass. G.L. c. 63, §§11(a)(1), (b)(1), be declared invalid as applied to Federal savings and loan associations.

Respectfully submitted,

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# Appendix.

12 U.S.C. §1726(b) establishes a reserve requirement for Federal savings and loan associations as follows, in connection with the application for required insurance:

... Each applicant for such insurance shall also file with its application an agreement that during the period that the insurance is in force it ... will provide adequate reserves satisfactory to the Corporation, to be established in accordance with regulations made by the Corporation, before paying dividends to its insured members; but such regulations shall require the building up of reserves to 5 per centum of all insured accounts within a reasonable period, not exceeding twenty years, and shall prohibit the payment of dividends from such reserves, or the payment of any dividends if any losses are chargeable to such reserves: *Provided*, That the Corporation may extend the twenty-year limitation hereinabove prescribed by not more than ten years in the case of any insured institution if it determines such action to be necessary to meet mortgage needs: *Provided further*, That for any year dividends may be declared and paid when losses are chargeable to such reserves if the declaration of such dividends in such case is approved by the Corporation. As used in this subsection the term "reserves" shall, to such extent as the Corporation may provide, include capital stock and other items, as defined by the Corporation.

Massachusetts General Laws, Chapter 170, §38 establishes a required guaranty fund for Massachusetts cooperative banks as follows:

Every such corporation shall establish and maintain a guaranty fund to be used to meet losses in its

business from depreciation, disposal or other change in its assets, or to establish reserves therefor. There may be transferred to such fund from the surplus account or other reserve accounts such amounts as the directors from time to time may determine.

At each distribution date and until such fund is at least equal to ten per cent of the assets of the corporation, there shall be transferred thereto five per cent of the net profits; provided, however, that if at any distribution date the guaranty fund and surplus account together amount to at least eleven per cent of the share liability of the corporation, the transfer to the guaranty fund hereinbefore described shall not be required if an equivalent amount is transferred from the surplus account to the guaranty fund.

Massachusetts General Laws, Chapter 168, §58 establishes a required guaranty fund for Massachusetts savings banks as follows:

Such corporation shall establish and maintain a guaranty fund subject to the conditions, limitations and requirements of this section.

1. *Transfers From Income.*—The trustees shall, as of the close of each ordinary dividend period, cause to be transferred to the guaranty fund until it amounts to seven and one-half per cent of the whole amount of deposits, not less than one-eighth nor more than one-fourth of one per cent of the whole amount of deposits, if the dividend period is six months, or a proportional percentage of such amount of deposits if the dividend period is less than six months, provided that the trustees may at their election make the whole or any part of any such transfer to surplus instead of to the guaranty fund, if immediately after said

transfer the guaranty fund shall amount to not less than five per cent of the whole amount of deposits; and provided further that no amount shall be required to be transferred to the guaranty fund if at the close of any dividend period the guaranty fund shall amount to not less than five per cent of the whole amount of deposits and either the guaranty fund and surplus in the aggregate amount to not less than eleven per cent of the whole amount of deposits, or the surplus, undivided profits and reserves, at the beginning of the taxable year of such corporation, determined in accordance with federal income tax laws and regulations relating to mutual savings banks, shall in the aggregate amount to not less than twelve per cent of the whole amount of deposits. For the purposes of such transfers, the whole amount of deposits shall be the amount appearing as of the close of business on the day immediately preceding the day on which deposits go on interest for the next ordinary dividend period, excluding the dividend paid or payable for the period so closed. Except as provided in paragraph 2 of this section, such transfers shall be made from the income which has accumulated since the last preceding ordinary dividend.

2. *Other Transfers.*—The amounts required or permitted to be transferred to the guaranty fund as above prescribed may, by vote of the trustees, be provided by transfers from surplus, other than the bad debt reserve, if immediately prior to any such transfer (a) the guaranty fund and surplus shall in the aggregate amount to at least eleven per cent of the whole amount of deposits, or (b) the surplus, undivided profits and reserves, at the beginning of the taxable year of such corporation, determined in accordance with federal



income tax laws and regulations relating to mutual savings banks, shall in the aggregate amount to at least twelve per cent of the whole amount of deposits. Subject to the written approval of the commissioner, the trustees may cause to be transferred to the guaranty fund from surplus, other than the bad debt reserve, such amounts and at such times as they deem to be in the best interests of the depositors, if thereby such fund is not increased beyond the limit fixed by paragraph 1 of this section.

3. *Use of Guaranty Fund.*—The guaranty fund shall be held to meet losses in the business of such corporation; provided, however, that except with the written approval of the commissioner, no losses shall be met from such fund if thereby the fund would be reduced to less than seven and one-half per cent of the whole amount of deposits.